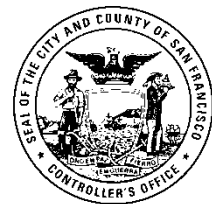


### **PORT COMMISSION:**

**Pier 39 Underpaid Its Rent by \$44  
Because It Did Not Report  
Subtenant Rent Underpayments for  
December 29, 2008, Through  
December 25, 2011**



*May 22, 2013*

**OFFICE OF THE CONTROLLER  
CITY SERVICES AUDITOR**

The City Services Auditor (CSA) was created in the Office of the Controller through an amendment to the Charter of the City and County of San Francisco (City) that was approved by voters in November 2003. Charter Appendix F grants CSA broad authority to:

- Report on the level and effectiveness of San Francisco's public services and benchmark the City to other public agencies and jurisdictions.
- Conduct financial and performance audits of city departments, contractors, and functions to assess efficiency and effectiveness of processes and services.
- Operate a whistleblower hotline and website and investigate reports of waste, fraud, and abuse of city resources.
- Ensure the financial integrity and improve the overall performance and efficiency of city government.

CSA may conduct financial audits, attestation engagements, and performance audits. Financial audits address the financial integrity of both city departments and contractors and provide reasonable assurance about whether financial statements are presented fairly in all material aspects in conformity with generally accepted accounting principles. Attestation engagements examine, review, or perform procedures on a broad range of subjects such as internal controls; compliance with requirements of specified laws, regulations, rules, contracts, or grants; and the reliability of performance measures. Performance audits focus primarily on assessment of city services and processes, providing recommendations to improve department operations.

CSA conducts its audits in accordance with the Government Auditing Standards published by the U.S. Government Accountability Office (GAO). These standards require:

- Independence of audit staff and the audit organization.
- Objectivity of the auditors performing the work.
- Competent staff, including continuing professional education.
- Quality control procedures to provide reasonable assurance of compliance with the auditing standards.

For questions about the report, please contact Director of City Audits Tonia Lediju at [Tonia.Lediju@sfgov.org](mailto:Tonia.Lediju@sfgov.org) or 415-554-5393, or CSA at 415-554-7469.

CSA Audit Team: Winnie Woo, Associate Auditor

Audit Consultants: KPMG LLP



**CITY AND COUNTY OF SAN FRANCISCO**  
**OFFICE OF THE CONTROLLER**

**Ben Rosenfield**  
**Controller**

**Monique Zmuda**  
**Deputy Controller**

May 22, 2013

San Francisco Port Commission  
Pier 1, The Embarcadero  
San Francisco, CA 94111

Ms. Monique Moyer  
Executive Director  
Port of San Francisco  
Pier 1, The Embarcadero  
San Francisco, CA 94111

Dear Commission President, Commissioners, and Ms. Moyer:

The City and County of San Francisco's Port Commission (Port) coordinates with the Office of the Controller's City Services Auditor Division (CSA) to conduct periodic concession and compliance audits of the Port's tenants. CSA engaged KPMG LLP (KPMG) to audit the Port's tenants to determine whether they comply with the reporting, payment, and other selected provisions of their leases.

CSA presents the attached report for the audit of Pier 39 Limited Partnership (Pier 39) prepared by KPMG.

**Reporting Period:** December 29, 2008, through December 25, 2011

**Rent Paid:** \$7,970,772

**Results:**

Pier 39 underreported its gross revenues to the Port by not reporting underpayment of rent by its subtenants, resulting in an underpayment of \$44 in rent. During the audit period Pier 39 reported \$81,441,301 in gross revenues and paid \$7,970,772 in rent due to the Port.

The responses of the Port and Pier 39 are attached to this report.

CSA appreciates the assistance and cooperation of Port and tenant staff during the audit. For questions about the report, please contact me at [Tonia.Lediju@sfgov.org](mailto:Tonia.Lediju@sfgov.org) or 415-554-5393 or CSA at 415-554-7469.

Respectfully,

Tonia Lediju  
Director of City Audits

Attachment

cc: Mayor  
Board of Supervisors  
Budget Analyst  
Civil Grand Jury  
Public Library



KPMG LLP  
Suite 1400  
55 Second Street  
San Francisco, CA 94105

## **Performance Audit Report**

San Francisco Port Commission  
Port of San Francisco  
Pier 1, The Embarcadero  
San Francisco, California 94111

President and Members:

We have completed a performance audit of the gross rent receipts and related percentage rent reported and paid by Pier 39 Limited Partnership (Tenant) to the Port of San Francisco (Port) for the period from December 29, 2008 to December 25, 2011. We also evaluated the Tenant's internal controls over the completeness, accuracy, and timeliness of reporting gross rent receipts and percentage rent to the Port.

### **Objective and Scope**

The objective of this performance audit was to determine whether the Tenant was in substantial compliance with the reporting, payment, and other rent-related provisions of its ground lease #L-9707, as amended, with the City and County of San Francisco (City), operating through the San Francisco Port Commission (Port Commission). To meet the objective of our performance audit we: verified that gross rent receipts for the audit period were reported to the Port in accordance with the lease provisions, and that such amounts agreed with the Tenant's underlying accounting records; identified and reported the amount and cause of any significant error(s) (over or under) in reporting, together with the impact on rent paid or payable to the Port; and identified and reported any recommendations to improve record keeping and reporting processes of the Tenant relative to its ability to comply with lease provisions.

The scope of our audit included the gross rent receipts and related percentage rent reported and paid or payable by the Tenant to the Port for the period from December 29, 2008 to December 25, 2011.

This audit and the resulting report relates only to the gross receipts and rent reported by the Tenant, and does not extend to any other performance or financial audits of either the Port Commission or the Tenant taken as a whole.

### **Methodology**

To meet the objective of our performance audit, we performed the following procedures: reviewed the applicable terms of the lease and the adequacy of the Tenant's procedures for collecting, recording, summarizing, and reporting its gross receipts and calculating its payments to the Port; judgmentally selected and tested samples of daily and monthly revenues; recalculated monthly rent due; and verified the accuracy and timeliness of reporting gross rent receipts and rent and submitting rent payments to the Port.



We conducted this performance audit in accordance with *Generally Accepted Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and recommendations based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and recommendations based on our audit objective.

### **Tenant Background**

North Point Center, Inc., the predecessor in interest to the Tenant, entered into a 60-year ground lease (Lease Agreement) on August 3, 1977 with the City, operating through the Port Commission, for the Pier 39 area in San Francisco. Subsequent amendments to the lease, among other things, transferred the lessee's rights and obligations to the Tenant and extended the ground lease term to December 31, 2042. The Tenant has over 100 subtenants and concessionaires. The Blue and Gold Fleet operates tour boats from Pier 39, and major mobile communications operators pay the Tenant for the right to have mobile communications antennas at Pier 39. Pier 39 also receives sponsorship revenues from various advertisers.

Pursuant to the Lease Agreement, rent consists of the following:

- 1) Minimum annual rent of \$500,000 per year, payable in equal monthly installments; and
- 2) Percentage rent, which consist of the following components:
  - a) The following percentages on all gross revenues from other than tour boats, sponsorships, and cellular sites:
    - i) Eight percent (8%) on the first \$10,000,000 of annual gross revenue;
    - ii) Nine percent (9%) on annual gross revenue of greater than \$10,000,000.01 and up to \$11,000,000;
    - iii) Ten percent (10%) on annual gross revenue of greater than \$11,000,000.01 and up to \$13,000,000;
    - iv) Eleven percent (11%) on annual gross revenue of greater than \$13,000,000.01 and up to \$15,000,000;
    - v) Fifty percent (50%) on annual gross revenue of greater than \$15,000,000.01 and up to \$15,763,000;
    - vi) Twelve percent (12%) on annual gross revenue of greater than \$15,763,000.01;
  - b) Seven percent (7%) of tour boat and sponsorship revenues;
  - c) Thirty percent (30%) of cellular sites revenues.

The Tenant is entitled to deduct minimum annual rent from percentage rent payable.



## Audit Results

The following summarizes total rent due and paid or payable to the Port, and any underpayment based on procedures performed and pursuant to the Lease Agreement as summarized above:

	52/53-week periods ended the last Sunday of December			Total
	2009	2010	2011	
Total rent due to the Port of of San Francisco:				
Minimum rent	\$ 500,000	\$ 500,000	\$ 500,000	\$ 1,500,000
Percentage rent	<u>2,037,674</u>	<u>2,160,312</u>	<u>2,272,799</u>	<u>6,470,785</u>
Total rent due to the Port of San Francisco	2,537,674	2,660,312	2,772,799	7,970,785
Less total rent paid or payable to the Port of San Francisco	2,537,730	2,660,185	2,772,857	7,970,772
(Underpayment) overpayment of rent	\$ <u>56</u>	\$ <u>(127)</u>	\$ <u>58</u>	\$ <u>(13)</u>

Gross rent receipts and related percentage rent calculations are summarized in Appendix A.



**Finding 1 – Tenant Did Not Report and Submit to the Port Underpayments of Rent by Sublessees Identified in Gross Revenue Audits**

Criteria	<p>Section III, D.2 of the October 31, 1979 lease amendment requires the Tenant to pay “...without abatement, except as hereinafter provided, a percentage of its gross revenues...” To comply with this provision, the Tenant requires in its sublease agreements subtenants to report all applicable gross receipts and pay the applicable rent to the Tenant.</p> <p>Subleases allow the Tenant to audit the gross receipts and percentage rent of its sublessees. The results of these sublessee gross receipts and percentage rent audits may result in additional rent due to the Tenant, which in turn may result in additional percentage rent due to the Port.</p>
Condition	<p>The Tenant conducted five gross receipts audits of sublessees to ensure sublessees reported all gross receipts and identified \$2,393 in rent due to the Tenant. However, the additional rent due and related audit findings were not reported or paid to the Port. Two reports covered the three-year period ended December 31, 2009 with report dates in December 2010. These reports identified \$1,577 of rent due to the Tenant. Two reports covered the three-year period ended December 31, 2010 with report dates in April 2012. These reports identified \$816 of rent due to the Tenant. The fifth report covered the four-year period ended December 31, 2011 with a report date in April 2012. This report identified no additional rent due to the Tenant.</p> <p>In addition to the amounts quantified in the gross receipts audit reports, the following nonquantified findings were identified in the reports: Two reports included findings for the value of employee meals improperly excluded from gross receipts; two reports identified findings for the value of employee discounts improperly excluded from gross receipts; two reports had findings for promotional discounts improperly excluded from gross receipts; and one report had a finding for the value of promotional coupons excluded from gross receipts.</p>
Cause	<p>The cause for the nonreporting of the additional rent due from the Tenant to the Port was inadequate internal controls over reporting adjustments to rents received from sublessees.</p>
Effect	<p>The Tenant did not comply with Section III.2.D of the Lease Agreement as they did not report all gross receipts to the Port. Based on the audits performed by the Tenant, and as calculated in Appendix B, the Tenant underreported gross receipts by \$2,393, which resulted in the underpayment of rent by \$44. Since we were not engaged to perform a performance audit of gross receipts and percentage rent for periods prior to December 29, 2008, and therefore did not have the information to determine which percentage rent percentage(s) should be used, we did not calculate underreported percentage rent for the two 52/53-week periods ended December 28, 2008.</p>





- Recommendation #1 We recommend that the Port request the Tenant to implement procedures to ensure that all gross receipts are reported to the Port from the subleases to comply with the Lease Agreement.
- Recommendation #2 We further recommend the Port collect all percentage rents due from the Tenant resulting from its sublessee gross receipts audits, including but not limited to the \$44 of underreported percentage rent during the two 52/53-week periods ended December 26, 2010.
- Recommendation #3 We recommend that the Port investigate and quantify the impact of underreported gross receipts on percentage rent for the two 52/53-week periods ended December 28, 2008.
- Recommendation #4 We also recommend that the Port obtain the Tenant's position on the nonquantified findings in the gross receipts audit reports to determine if additional percentage rents should be collected from the Tenant.

## **Finding 2 – Not All Sales Tax Returns Are Available for Evaluation**

- Criteria Section III, D.2 of the October 31, 1979 lease amendment requires the Tenant to pay "...without abatement, except as hereinafter provided, a percentage of its gross revenues..."
- Further, Section IV, B of the October 31, 1979 lease amendment requires that "...copies of all sales and other excise tax reports or any other reports that Tenant, its subtenants, licensees and concessionaires, may be required to furnish any governmental agency shall at all reasonable times be open for inspection by Landlord..."
- To comply with the aforementioned provisions, the Tenant requires in certain sublease agreements that certain sublessees submit copies of their sales tax returns within 30 days of quarter-end.
- Condition During the performance of audit procedures, we selected a sample of 13 subleases for testwork and requested sales tax returns from the respective sublessees. As of the completion of fieldwork, the Tenant had been provided only one of the three requested quarterly sales tax returns from one of the 13 sublessees tested, and none of the three requested quarterly sales tax returns from another sublessee which was selected for testwork.
- Cause For the sublessee that had provided only one of the three quarterly sales tax returns, the Tenant did not enforce its existing lease provisions that required the submission of sales tax returns. For the sublessee that did not provide any of the sales tax returns, the sublease provisions allowed the sublessee to refuse to provide the sales tax returns to the Tenant.



- Effect                      Although our performance audit found no underpayments of rent resulting from the subleases, the Tenant did not have the ability to verify any information provided by the subtenant, which could have resulted in underreported gross receipts and related percentage rent payable to the Port.
- Recommendation #5      We recommend that the Port require the Tenant to enforce the applicable sublease provisions that require certain sublessees to submit quarterly sales tax returns. We also recommend that the Port evaluate its options with the Tenant for those subleases/sublessees that currently are not required to submit quarterly sales tax returns. These options include, but are not necessarily limited to, renegotiation of the sales tax return submission requirement, and/or specific gross receipts and percentage rent audits of these sublessees.

### **Conclusion**

Based upon the performance audit procedures performed and the results obtained, we have met our audit objective. We conclude that, except for the conditions identified above, the Tenant was in substantial compliance with the reporting, payment, and other rent-related provisions of its lease #L-9707 with the Port. We did not identify any additional recommendations or findings to improve record keeping and reporting processes of the Tenant relative to its ability to comply with lease provisions.

This performance audit did not constitute an audit of financial statements in accordance with *Government Auditing Standards* or U.S. generally accepted auditing standards. KPMG was not engaged to, and did not render an opinion on the Tenant's internal controls over financial reporting or over the Tenant's financial management systems.

This report is intended solely for management and members of the San Francisco Port Commission, the Board of Supervisors and management of the City and County of San Francisco, and management of Pier 39 Limited Partnership and is not intended to be and should not be used by anyone other than these specified parties.

*KPMG LLP*

February 27, 2013

## PIER 39 LIMITED PARTNERSHIP

## Calculation of Percentage Rent

For the years ended December 31, 2009 – 2011

	Year ended December 31			Total
	2009	2010	2011	
Gross receipts from:				
Other than sponsorships, tour boats and cellular sites:				
As reported	\$ 17,671,182	\$ 18,216,648	\$ 19,064,768	\$ 54,952,598
Audit adjustments	(467)	839	—	372
As audited	17,670,715	18,217,487	19,064,768	54,952,970
Sponsorships	1,020,805	909,686	1,001,808	2,932,299
Tour boats	7,498,268	7,644,827	7,880,653	23,023,748
Cellular sites	69,711	251,528	211,045	532,284
Total gross receipts	<u>\$ 26,259,499</u>	<u>\$ 27,023,528</u>	<u>\$ 28,158,274</u>	<u>\$ 81,441,301</u>
Percentage rent on gross receipts from:				
Other than sponsorships, tour boats and cellular sites:				
8% on the first \$10,000,000	\$ 800,000	\$ 800,000	\$ 800,000	\$ 2,400,000
9% on the next \$1,000,000	90,000	90,000	90,000	270,000
10% on the next \$2,000,000	200,000	200,000	200,000	600,000
11% on the next \$2,000,000	220,000	220,000	220,000	660,000
50% on the next \$763,000	381,500	381,500	381,500	1,144,500
12% thereafter	228,926	294,538	396,212	919,676
Subtotal	1,920,426	1,986,038	2,087,712	5,994,176
Sponsorships (7%)	71,456	63,678	70,127	205,261
Tour boats (7%)	524,879	535,138	551,646	1,611,663
Cellular sites (30%)	20,913	75,458	63,314	159,685
Percentage rent before deduction for minimum annual rent	2,537,674	2,660,312	2,772,799	7,970,785
Deduction for minimum annual rent	(500,000)	(500,000)	(500,000)	(1,500,000)
Percentage rent due to the Port	<u>\$ 2,037,674</u>	<u>\$ 2,160,312</u>	<u>\$ 2,272,799</u>	<u>\$ 6,470,785</u>

**PIER 39 LIMITED PARTNERSHIP**

## Summary of Third-Party Gross Revenue Audits of Sublessees

For the years ended December 31, 2007 – 2011

	Year ended December 31					Total
	2007	2008	2009	2010	2011	
Over (under) rent reported by sublessees:						
Sublessee 1	\$ —	\$ —	\$ (141)	N/A	N/A	\$ (141)
Sublessee 2	(1,247)	(429)	240	N/A	N/A	(1,436)
Sublessee 3	N/A	(345)	368	(178)	N/A	(155)
Sublessee 4	N/A	—	—	(661)	N/A	(661)
Sublessee 5	N/A	—	—	—	—	—
Total over (under) reported rent by sublessees	(1,247)	(774)	467	(839)	—	\$ <u>(2,393)</u>
Times percentage rent percentage	Unknown	Unknown	12%	12%	12%	
Over (under) reported rent to the Port of San Francisco	<u>Unknown</u>	<u>Unknown</u>	\$ <u>56</u>	<u>(100)</u>	<u>—</u>	\$ <u>(44)</u>

# PIER 39

April 3, 2013

Ms. Katherine Yoshii  
Yano Accountancy Corporation  
201 California Street, Suite 411  
San Francisco, CA 94111-5006

Dear Ms. Yoshii,

We have received a copy of your Performance Audit Report to the Port of San Francisco and submit the following in response to your findings:

Finding 1. Tenant did not report and submit to the Port underpayment of rent by sublessees identified in gross receipts audit.

Response: PIER 39 is not required to report to the Port underpayments of rent by its Subtenants; thus this Finding 1 is not relevant or material. PIER 39 is only required to report to the Port gross receipts actually received by PIER 39; by its very nature underpayments of rent are not received by PIER 39 and thus not reportable. There is no finding by the auditor that PIER 39 failed to report as required by the Port Lease.

Finding 1 - Condition. In paragraph two of the report it states that two of the sublessees audit reports included findings for "the value of employee meals improperly excluded from gross receipts" and "the value of employee discounts improperly excluded from gross receipts."

Response: The foregoing statement does not accurately reflect what was contained in the Subtenant audit. The audit states that "the tenant excluded the value of discounts granted on sales to employees" and "excluded the value of meals to employees." The audit also stated that in some cases the auditors were unable to quantify the amount of the discounts and employee meals. Since the Subtenant Sublease defines "gross sales" as "...the entire amount of the actual sales price, whether wholly or partly for cash or credit..", Subtenant employee benefits for meals and discounts cannot be considered "gross sales" as the Subtenant is not obtaining "cash or credit"; it does not get paid for such employee benefits. Furthermore, exclusions from "gross sales" are only relevant in calculating the Subtenant's "percentage rent" against "minimum monthly rent", and were not material in the examples cited. PIER 39 will, of course, clarify these concepts with its third party Subtenant auditors.

Finding 1 – Condition. In paragraph two of the report it also states that two of the reports had findings for "promotional discounts improperly excluded from gross receipts".

Response: The foregoing statement does not accurately reflect what was contained in the Subtenant audit. The audit does not state that the promotional discounts were improperly excluded from gross receipts. The Subtenant audit report states that the "tenant excluded the value of promotional discounts." Since the Subtenant Sublease defines "gross sales" as "...the entire amount of the actual sales price, whether wholly or partly for cash or credit..", promotional discounts cannot be considered "gross sales" as the Subtenant is not obtaining "cash or credit"; it does not get paid for the discounted portion of any sale. Furthermore, exclusions from "gross sales" are only relevant in calculating the Subtenant's "percentage rent" against "minimum monthly rent", and were not material in the examples cited. PIER 39 will, of course, clarify these concepts with its third party Subtenant auditors.

Effect: The report states that the "Tenant did not comply with Section III.2.D. of the Lease Agreement as they did not report all gross receipts to the Port."

Response: PIER 39 denies that it has in any way failed to comply with the provisions of Section III.2.D or any other part of the Port Lease. The auditor fails to cite any example where PIER 39 failed to report any gross receipt that it actually received during the period audited.

Finding 1. Recommendation #1. Response: PIER 39 has in place adequate procedures to ensure that all gross receipts collected by it from Subtenants are properly reported to the Port. Given that the auditor does not cite any example where PIER 39 failed to properly report gross receipts actually received from Subtenants, no additional reporting procedures are necessary.

Finding 1. Recommendation #2. Response: PIER 39 will review or has already reviewed the Subtenant audits for the two years ended December 26, 2010, and, as appropriate, has billed or will bill the applicable Subtenants for any additional percentage rent that may be due. If and when any such additional percentage rent is collected from the Subtenants, PIER 39 will, as is its consistent practice, include the amounts actually received in its report of gross receipts to the Port, and, of course, pay any Port rent due as a result thereof.

Finding 1. Recommendation #3. Response: PIER 39 will review the Subtenant audits for the two years ended December 28, 2008, and, as appropriate, will bill the applicable Subtenants for any additional percentage rent that may be due. If and when any such additional percentage rent is collected from the Subtenants, PIER 39 will, as is its consistent practice, include the amounts actually received in its report of gross receipts to the Port, and, of course, pay any Port rent due as a result thereof.

Finding 1. Recommendation #4. Response: PIER 39 will review all Subtenant leases in order to determine if a clarification of the definition of gross sales is necessary and, to the extent found to be necessary and practicable, will take steps to clarify the same. Furthermore, PIER 39 will communicate with its third party Subtenant auditors on this issue in order to ensure that the definition of "gross sales" is clear. PIER 39 is confident that this will help eliminate any future misunderstanding.

Finding 2 – Not All Sales Tax Returns Are Available for Evaluation

Response: The auditor has misstated the relevant provision of the Port Lease. Section IV, B of the October 31, 1979 Amendment does not state that PIER 39 has any obligation to obtain and maintain its Subtenants' sales tax returns. The Section states that any sales and excise tax reports of "subtenants, licensees and concessionaires . . . shall at all reasonable times be open for inspection by Landlord at such place or places as . . . subtenants', licensees' and concessionaires' records are kept". In other words, such records only have to be available to the Port where the records are kept; there is no obligation on the part of PIER 39 to gather the records for the Port.

PIER 39 will, nevertheless, advise its applicable Subtenants in writing of their obligations under their respective subleases to submit copies of their sales taxes returns.

Finding 2. Condition. The auditor states that we did not provide all of the Subtenant's sales tax returns requested. We believe this statement to be inaccurate. With the exception of one Subtenant that underwent a change in financial management, to the best of our knowledge and belief, for all Subtenants whose sublease contained a provision requiring submission of sales tax returns, we provided copies of all of the Subtenant sales tax returns requested by the auditor.

Finding 2. Effect. The auditor's statement that PIER 39 did not have the ability to verify Subtenant gross sales is not accurate. The submission of sales tax returns by Subtenants is not the only option available to verify sales reporting by PIER 39's Subtenants. PIER 39 has secured the right in each of its Subtenant Subleases to audit all of the business records of its Subtenants, and it does so regularly.

Finding 2. Recommendation #5. The auditor's recommendation is not relevant and not possible under the Port Lease. First, since the Port Lease does not require PIER 39 to collect sales tax information from its Subtenants, asking PIER 39 to now do so is not feasible. Second, since there is no evidence of any underpayments, this recommendation is not necessary. Third, as stated above, the collection and review of sales tax returns is not PIER 39's only option in verifying Subtenant gross sales. Every Subtenant Sublease contains a provision empowering PIER 39 to conduct an audit of Subtenant's business records of all kinds in order to verify such gross sales; PIER 39 regularly conducts audits of its Subtenants.

Sincerely,



Elinor Heller

Vice President, Controller



May 3, 2013

Tonia Lediju, Director of City Audits  
Office of the Controller  
City and County of San Francisco  
1 Dr. Carlton B. Goodlett Place, Room 477  
San Francisco, CA 94102

Re: Tenant Performance Audit – Pier 39 Limited Partnership

Dear Ms. Lediju:

Thank you for the opportunity to review the draft performance audit report prepared by KPMG LLP covering Port lease no. L-9707 with Pier 39 Limited Partnership. Based on the report details provided by KPMG, Port management accepted the report. We subsequently reviewed the tenant's April 3, 2013 response letter addressed to Yano's Accountancy Corporation, KPMG's contract partner for this audit.

The attached Port response on the City's standard Recommendations and Responses form takes into consideration Pier 39's detailed response, which included commitments to implement various responsive actions. The Port will follow up, as necessary, to ensure that all relevant issues from the audit are adequately addressed.

Please don't hesitate to contact me at (415) 274-0515 if you have any questions.

Sincerely,

John J. J. Woo  
Fiscal Officer

Enclosure

Cc: Elaine Forbes, Director of Finance and Administration  
Susan Reynolds, Director of Real Estate  
Oanh Nguyen, KPMG LLP



## PORT COMMISSION: PERFORMANCE AUDIT OF PIER 39 LIMITED PARTNERSHIP

For each recommendation, indicate whether the department concurs, does not concur, or partially concurs. If the department concurs with the recommendation, please indicate the expected implementation date and implementation plan. If the department does not concur or partially concurs, please provide an explanation and an alternate plan of action to address the identified issue.

## RECOMMENDATIONS AND RESPONSES

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Recommendation	Responsible Agency	Response
1. The Port should request that the Tenant implement procedures to ensure that all gross receipts are reported to the Port from the subleases to comply with the Lease Agreement.	Port Commission	<p>Partially concur. The Port read and considered Pier 39's written response dated April 3, 2013. The Port accepts cash basis reporting from Pier 39 under this lease; i.e. revenues reportable to the Port may be based on "gross receipts actually received." Actual or potential rent deficiencies on this reporting basis are addressed in #2.</p> <p>The Port accepts Pier 39's detailed response. No additional follow-up action is necessary for this recommendation.</p>
2. The Port should collect all percentage rents due from the Tenant resulting from its sublessee gross receipts audits, including but not limited to \$44 of underreported percentage rent during the two 52/53 week periods ended December 26, 2010.	Port Commission	<p>Partially concur. Immediate follow-up within 30 days of final report.</p> <p>The Port read and considered Pier 39's written response dated April 3, 2013. As noted above in #1, the Port accepts cash basis reporting from Pier 39. Pier 39's response action to this recommendation is accepted; and we look forward to future reporting from Pier 39, as may be necessary, of reportable amounts emanating from the two fiscal year periods ended December 26, 2010.</p> <p>The Port will follow-up to confirm that Pier 39 completed its review of the past subtenant audits, billed subtenants for any rental payment deficiencies due Pier 39, and reported, or will report shortly, any additional collection of such payment deficiencies in a subsequent report of Pier 39 gross receipts to the Port.</p>

**PORT COMMISSION: PERFORMANCE AUDIT OF PIER 39 LIMITED PARTNERSHIP**

Recommendation	Responsible Agency	Response
<p>3. The Port should investigate and quantify the impact of underreported gross receipts on percentage rent for the two 52/53 week periods ended December 28, 2008.</p>	<p>Port Commission</p>	<p>Agree. Immediate follow-up request within 30 days of final report. We will request information from Pier 39 concerning the two back years prior to the period examined by the independent auditor.</p> <p>The Port read and considered Pier 39's written response dated April 3, 2013. Pier 39's response action to this recommendation is accepted; and we look forward to future reporting from Pier 39, as may be necessary, of reportable amounts emanating from the two fiscal year periods ended December 28, 2008.</p>
<p>4. The Port should obtain the Tenant's position on the nonquantified findings in the gross receipts audit reports to determine if additional percentage rents should be collected from the Tenant.</p>	<p>Port Commission</p>	<p>The Port read and considered Pier 39's written response dated April 3, 2013. As revenues reportable to the Port is based on the gross receipts actually received, the effect of non-cash transaction elements, like promotional discounts, do not need to be quantified for the purposes of determining the rental obligation under the Pier 39 lease and associated subtenant leases.</p> <p>The Port accepts Pier 39's detailed response, to review and possibly clarify the definition of gross sales in subtenant leases and/or in its instruction to third party auditors. No additional follow-up action is required.</p>
<p>5. The Port should require that the Tenant enforce the applicable sublease provisions that require certain sublessees to submit quarterly sales tax returns. The Port should evaluate its options with the Tenant for those subleases/sublessees that currently are not required to submit quarterly sales tax returns. These options include, but are not necessarily limited to, renegotiation of the sales tax return submission requirement, and/or specific gross receipts and percentage rent audits of these sublessees.</p>	<p>Port Commission</p>	<p>Partially concur. The review and reconciliation of sales tax returns is one primary and common vehicle for evaluating the propriety of reported sales information. However, we agree with Pier 39 that it is not the only option.</p> <p>The Port read and considered Pier 39's written response dated April 3, 2013. The Port accepts Pier 39's detailed response and no further follow-up action is deemed necessary at this time.</p>